

FINAL STATEMENT OF REASONS

Adoption of CCR Section 559.

Disclosure of Placement Agent Fees, Gifts and Campaign Contributions

Update of Initial Statement of Reasons

There have been no changes in the applicable laws or facts, or to the effect of the proposed regulations, from those described in the Initial Statement of Reasons except as described below.

Assembly Bill 1743

Assembly Bill (AB) 1743 (Hernandez) was adopted by the Legislature and signed by the Governor on September 1, 2010. The primary purpose of AB 1743 is to require placement agents to register as lobbyists pursuant to the Political Reform Act. However, AB 1743 also amended statutes originally adopted pursuant to Assembly Bill 1584 (Hernandez) that, as explained in the initial statement of reasons, led to CalPERS proposing this regulation. For example, the definition of placement agent originally found in AB 1584 is amended by AB 1743. As the proposed regulation progressed through the rulemaking process, it became apparent that the proposed regulation and AB 1743 should be consistent. Several written comment letters made this suggestion and requested that the regulation be delayed while AB 1743 progressed through the legislative process. As a result, conforming changes to the proposed regulation were made when it became apparent that AB 1743 would likely become law. The changes made to the proposed regulation to conform it to AB 1743 are explained in detail in the attached copy of the September 13, 2010, Agenda Item 3 of the Investment Committee incorporated herein by reference. AB 1743 becomes effective January 1, 2011. For legislative history regarding AB 1743, please see <http://www.leginfo.ca.gov/>.

The majority of changes to the proposed regulation driven by AB 1743 are technical in nature. These changes were, in part, a response to an analysis of AB 1743 done by Mr. Keith Bishop, former Commissioner of the Department of Corporations. The attached copy of Mr. Bishop's letter to Assembly Member Ed Hernandez dated May 20, 2010, is incorporated by reference as Attachment 5 to the September 13, 2010.

In summary, Mr. Bishop commented that AB 1743, and by extension the proposed regulation, did not do a good job of using established securities law terminology to describe and differentiate between: (a) external managers who provide investment management services pursuant to contract; and, (b) those external managers that manage a legal entity like a limited partnership or limited liability company that offers securities to investors, e.g., CalPERS hedge fund and private equity managers. The proposed changes to some of the definitions

within the regulation are a result of collaboration between the CalPERS Legal Office, including outside counsel, and Mr. Bishop. Changes to the definition of "External Manager" based on Mr. Bishop's comments occur in subsection (a)5. Other changes to the proposed regulation made in response to Mr. Bishop's May 20, 2010 letter include the addition of the definition of "Person," amendments to the definitions of "CalPERS Vehicle," "Placement Agent," subsection (d)(6), and other minor style and technical changes.

Summary and Response to Comments Received During the Public Notice Periods Involving the Proposed Regulation

As further discussed in the attached June 14, 2010, Agenda Item 4 and the September 13, 2010, Agenda Item 3 of the CalPERS Investment Committee, CalPERS received public comment in response to the initial comment period. The initial comment period was from April 2, 2010 through June 14, 2010. The letters received from the Rockpoint Group, LLC and the Rock Creek Group, LP in response to the initial notice are discussed in the June 14, 2010 agenda item. Other comment letters received by CalPERS in response to the initial comment period were from SIFMA, Skadden, Arps, Slate, Meagher & Flom LLP, the National Venture Capital Association, Forward Ventures, Enterprise Partners, Mission Ventures, and Keith Paul Bishop. These letters were not received in time to be fully considered in the June 14, 2010 agenda item. They were responded to in detail in the September 13, 2010 agenda item. As explained in the September 13, 2010 agenda item, there were many changes to the proposed regulation in response to the written comments. In addition, information in the original notice was updated or clarified in the September 13, 2010 agenda item and/or notices of amendments to the proposed regulation. In addition to the original notice period, two other comment periods were noticed in response to amendments to the proposed regulation. The additional comment periods were August 12, 2010 -- August 26, 2010 and October 1, 2010 -- October 15, 2010. No written comments were received in response to either of these additional notices.

Summary of the comments and CalPERS' response are below. The comments themselves can be found as attachments to the June 14, 2010 and September 13, 2010 agenda items.

Rockpoint Group, L.L.C. (Rockpoint) Comment Letter

Rockpoint commented that an amendment to a partnership agreement to cancel or continue the partnership should not trigger a placement agent disclosure. CalPERS disagrees since the decision to terminate is the type of decision where a placement agent might be utilized given the impact on the fund manager's revenue resulting from termination of a fund.

Rockpoint also commented that internal employees should be largely exempt from the definition of placement agent. CalPERS disagrees since excluding all in-house employees would be too large a loophole. However, see the discussion below relating to the NVCA Comment Letter.

Rockpoint also commented that certain disclosures should be limited to “matters known by the senior officers of the external manager.” CalPERS disagrees since it believes the external manager within an organization has an obligation to take reasonable steps to confirm the accuracy of the facts provided in the placement agent disclosure. Limiting knowledge to that information held by senior officers would necessitate defining seniors officers and would unduly weaken the policy.

Finally, Rockpoint commented that requiring external managers to update information within 14 business days was unrealistic. CalPERS disagrees noting that updates are required only where the external manager knows or should have known an update is necessary. CalPERS suggests that an external manager may want to put contractual mechanisms into place with its placement agents to help ensure compliance. CalPERS finally notes that we must put the burden of reporting on external managers since we are not in contractual privity with placement agents.

The Rock Creek Group (Rock Creek) Comment Letter

Rock Creek commented that in-house marketers could be covered by the definition of placement agent. As stated elsewhere, CalPERS believes that exempting all in-house employees would be too large a loophole. However, see the discussion below relating to the NVCA Comment Letter.

Rock Creek also commented that mandatory adherence to future amendments via a contract agreement was unfair. CalPERS responds that there is no such requirement in the regulation.

Finally, Rock Creek commented that there was uncertainty when “investment discussions” are deemed “initiated” for the 45 day deadline for requiring a placement agent disclosure. CalPERS responds that it is necessary to have disclosure early in the process to better evaluate any disclosures made and that since the asset classes have different and evolving investment processes, it is difficult to more precisely define when investment discussions are deemed initiated.

SIFMA Comment Letter

SIFMA supports enhanced disclosure of placement agent fees and relationships, but asked for clarification on three issues. First, SIFMA sought confirmation that only placement agent agreements that could result in compensation to a placement agent based on a CalPERS investment be disclosed. CalPERS

agrees and minor clarifying changes were made to the proposed regulation and forms.

Second, SIFMA requests that CalPERS not require copies of written placement agent agreements or that the written agreement be redacted to exclude “proprietary and confidential information and/or trade secrets.” CalPERS disagrees and believes that full disclosure of placement agent compensation is crucial to the effectiveness of the regulation. CalPERS believes that a review of the entire written agreement is necessary in order to fully understand the compensation paid to a placement agent.

Finally, SIFMA suggested waiting to finalize the proposed regulation until AB 1743 was further along in order to resolve conflicts between the proposed regulation and the proposed statutes. As noted above, the proposed regulation is now consistent with the essential provisions of AB 1743.

Skadden Arps Comment Letter

Skadden Arps requested delaying the proposed regulation to assure consistency with AB 1743. Staff generally agreed but noted that AB 1743 does exempt one group of potential placement agents from the definition of lobbyist while still requiring disclosure of any agreements relating to that group. Specifically, individuals that meet the criteria below are exempt from the definition of lobbyists for purposes of the Political Reform Act, but are still subject to disclosure pursuant to the regulation.

An employee, officer, or director of an external manager, of an affiliate of an external manager, is not a placement agent if all of the following apply:

- (1) The external manager is registered as an investment adviser or a broker-dealer with the Securities and Exchange Commission or, if exempt from or not subject to registration with the Securities and Exchange Commission, any appropriate state securities regulator.
- (2) The external manager has been selected through a competitive bidding process subject to subdivision (a) of Section 22364 of the Education Code or subdivision (a) of Section 20153 of this code, as applicable, and is providing services pursuant to a contract executed as a result of that competitive bidding process.
- (3) The external manager has agreed to a fiduciary standard of care, as defined by the standards of conduct applicable to the retirement board of a public pension or retirement system and set forth in Section 17 of Article XVI of the California Constitution, when managing a portfolio of assets of a state public retirement system in California.

This exception was the result of a comment letter on AB 1743 by the Investment Advisers Association (“IAA”) and a series of communications between the IAA, staff, and the co-sponsors of AB 1743. The IAA letter is attached as Attachment 6 to the September 13, 2010 agenda item and is incorporated by reference. Though CalPERS believes that the IAA made a good case to have certain investment advisers exempt from the lobbyist registration requirement both CalPERS and IAA agreed that the same class of internal employees would remain subject to the disclosure rules relating to placement agents put in place pursuant to AB 1584.

National Venture Capital Association (“NVCA”) Comment Letter

NVCA believes the placement agent definition will capture internal employees who have limited and intermittent roles in fundraising processes, such as a venture capital firm’s chief financial officer (“CFO”). While NVCA accepts the definition of placement agent as contained in the CalPERS Placement Agent Policy dated November 16, 2009, it is concerned that the proposed regulation’s exception for investment professionals who spend one-third of their time, during a calendar year managing assets for CalPERS “introduces unnecessary ambiguity and appears to broaden the statutory definition of a ‘placement agent.’” Staff disagrees and instead believes that the typical CFO does not meet the definition of placement agent since he or she is not “hired, engage, retained by, or serving for the benefit of or on behalf of an external manager....in connection with the offer or sale of the securities, assets or services of an external manager to CalPERS or a CalPERS Vehicle.” CalPERS has had numerous discussions with NVCA on this point and has provided assurance that the addition of the exception for certain investment professionals was not intended to broaden the scope of who is placement agent in the first instance.

CalPERS received similar form letters from individual venture capital firms, including Forward Ventures, Enterprise Partners Venture Capital, and Mission Ventures, building on the NVCA’s concerns.

Keith Bishop’s Comment Letter

In addition to Mr. Bishop’s comment letter regarding AB 1743, Mr. Bishop submitted a letter containing two sets of comments addressing the proposed regulation. One set of comments concerned the adequacy of the regulatory notice and the other set concerned the text of the proposed regulation. CalPERS staff discussed many of Mr. Bishop’s notice issues with the Office of Administrative Law. While many of Mr. Bishop’s comments regarding regulatory notice might have some merit, staff nevertheless believes the notice was adequate.

Notice Related Comment #1: The Notice of Proposed Regulatory Action does not cite the proper authority and does not include all required references.

CalPERS agrees with Mr. Bishop's comments and amended the authority and reference sections of the proposed regulation.

Notice Related Comment #2: The Notice of Proposed Regulatory Action wrongly states that the proposed rule will not impact costs for any state agency.

CalPERS agrees with Mr. Bishop's comments that the proposed regulation will have some absorbable costs for CalPERS.

Notice Related Comment #3: The Notice of Proposed Regulatory Action wrongly states that CalPERS is not aware of the cost impacts on representative private persons or business.

CalPERS agrees with Mr. Bishop's comments and noticed a copy of Form 399 on August 25, 2010 which sets forth an estimate of the costs on representative private persons or businesses.

Notice Related Comment #4: CalPERS has not provided evidence that it has complied with Government Code section 11346.4.

CalPERS believes it has substantially complied with Government Code section 11346.4 and therefore made no additional revisions based on this comment.

Notice Related Comment #5: The Notice of Proposed Regulatory Action fails to provide a citation to the comparable federal regulation and a brief description of the differences.

CalPERS made no additional revisions based on this comment. The proposed regulation is required by AB 1584 which requires the disclosure of placement agent agreements with sufficient detail prior to the time any investment decisions are made by CalPERS. Rule 206(4)-3 of the Investment Advisers Act of 1940 does not require such disclosure.

Notice Related Comment #6: The Notice of Proposed Regulatory Action incorrectly states that the CalPERS Board of Administration proposes to amend regulations.

CalPERS agrees with Mr. Bishop's comments.

Text Related Comment #1: The proposed rule text does not include the required statement of authority and reference.

CalPERS added additional statutory references as suggested by Mr. Bishop.

Text Related Comment #2: The proposed definition of “Consultant” violates the clarity standard for regulations.

CalPERS disagrees but made some minor changes to the definition of “Consultant” in response to Mr. Bishop’s comments.

Text Related Comment #3: The proposed definition of “Placement Agent” violates the clarity standard for regulations.

CalPERS has kept the term consultant in the definition of “Placement Agent” but changed it to lower case in an attempt to signal the reader that the defined term is not to be utilized in that section.

Text Related Comment #4: The proposed requirement that disclosures be made by “any employee actively providing placement agent services” violates the clarity standard.

CalPERS disagrees. The proposed regulation specifies that: “When an entity is retained as a placement agent, any officer, director, or employee actively providing placement agent services with regard to CalPERS or receiving more than 15% of the placement agent fees shall provide information required by this subsection.”

Text Related Comment #5: The requirement that information must be updated within 14 calendar days of the date when the external manager should have known of the change in the information violates the clarity standard.

CalPERS disagrees but believes that adding a “reasonable” qualifier as suggested by Mr. Bishop is a good idea and has changed the proposed regulation accordingly.

Text Related Comment #6: The proposed rule incorrectly assumes that placement agents must be registered with the Securities and Exchange Commission, the Financial Industry Regulatory Authority, or the Commodity Future Trading Commission.

CalPERS is aware that not all placement agents have historically been required to register with the above entities. Nonetheless, the proposed regulation requires registration for the reasons set forth in the Initial Statement of Reasons: “Being subject to the Securities and Exchange Commission (SEC) or another regulatory agency provides some protection that a placement agent is subject to certain ethical obligations, levels of oversight, and enforcement. Because CalPERS invests globally and in a broad variety of assets, CalPERS allowed for registration with the SEC, the Commodity Futures Trading Commission and similar non-U.S. regulatory authorities.”

Text Related Comment #7: CalPERS does not have the authority to impose the remedies specified in the proposed rule.

CalPERS disagrees. CalPERS has broad rulemaking authority pursuant to Government Code sections 20120 and 20121.

Text Related Comment #8: The disclosure forms proposed by CalPERS must be adopted as regulations in accordance with the rulemaking provisions of the California Administrative Procedure Act.

CalPERS has incorporated the forms by reference into the latest revisions to the proposed regulations.

Text Related Comment #9: The proposed rule is not consistent with the California Public Records Act and the California Information Practices Act.

CalPERS disagrees. CalPERS will comply with the California Information Practices Act and the Public Records Act when implementing the proposed regulation.

Summary and Response to Comments Received at Public Hearings

A public hearing was held on June 14, 2010. At that meeting there was no public comment. Comments were, however, provided by members of the CalPERS Investment Committee. The transcripts of the public hearing are attached. Board member JJ Jelincic suggested that subdivision (h) was unclear. Staff made non-substantive changes to subdivision (h) in the proposed regulation noticed August 12, 2010 by deleting repetitive language in the paragraph. Board member Priya Mathur commented that the use of the term "Consultant" in the definition of placement agent should be changed to the undefined lower-cased "consultant." Staff made the suggested change to (a)(7) in the proposed regulation noticed August 12, 2010.

While not a "public hearing" for purposes of the Administrative Procedure Act, the CalPERS Investment Committee discussed the proposed regulation at the September 13, 2010 Investment Committee as a follow-up to the August 12, 2010 15-day notice of proposed regulatory changes. Board member Coony, delegate for Treasurer Bill Lockyer, moved, and the Investment Committee directed that the regulation be amended to require disclosure of political contributions and gifts to all Board members, not just elected Board members, as well as to persons who have the authority to appoint persons to the CalPERS Board of Administration. The amended regulation noticed October 1, 2010, made the suggested change to subsection (c) by removing the qualifier "elected" before "CalPERS Board member" and adding "or person(s) who has the authority to appoint a person to the CalPERS Board" in the appropriate places. At the same meeting, the Investment Committee gave staff the authority to finalize the

proposed regulations so long as there were no additional comments made in response to the amended regulation that was to be noticed to the public.

Staff Initiated Changes

As explained in the September 13, 2010 agenda item, the last sentence of section (d)(5) has been deleted such that CalPERS will no longer permit external managers to call capital from CalPERS to pay placement agents even where there is a corresponding reduction to the management fee paid by CalPERS. Staff believes that allowing general partners to pay placement agent fees out of CalPERS capital endorses the continued use of placement agents and leads to a perception that CalPERS is paying for the placement agent fees. Moreover, these provisions potentially allow a general partner to “borrow” against future management fees to pay placement agent fees.

Since the last noticed version of the proposed regulation on October 1, 2010, CalPERS has made nonsubstantial or solely grammatical changes to the proposed regulation. Specifically, the reference to July 16, 2010 in (b)(1) has been changed to August 12, 2010 since the July date was a typographical error. In addition, a comma was added after the first use of the word “Manager” in the first sentence of (d)4.b and an apostrophe was added changing “Vehicles” to “Vehicle’s” at the end of last sentence in (d)4.b.

Alternatives Determination

CalPERS has determined that no reasonable alternative considered by the Board or that has otherwise been identified and brought to the attention of the Board would be more effective in carrying out the purpose for which the action is proposed or would be as effective as and less burdensome to affected private persons than the proposed action.

Local Mandate Determination

The proposed regulation does not impose any mandate on local agencies or school districts.

Request for Early Effective Date

CalPERS requests that the regulation take effect when the regulation is filed with the Secretary of State. CalPERS wishes to provide definitive guidance to the external managers and placement agents impacted by this regulation as quickly as possible given the intense scrutiny and interest regarding implementation of the same. CalPERS regularly receives calls for clarifications regarding AB 1584, AB 1743, and the status of our regulations.